RICHARD RUSSELL'S **DOW THEORY LETTERS, INC.**

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May 7, DJIA 869.20; PTI 1422; A-D Ratio –23.38
May 14, DJIA 857.78; PTI 1414; A-D Ratio –23.62

THE MARKET: The most plentiful commodity on Wall Street today is confusion. The scarcest commodity on Wall Street is patience. If you read 30 current market publications you will probably find 10 bulls, 10 bears, and 10 straddlers (undecided, but ready to jump either way). Even the cock-sure, know-it-all analysts are a bit confused.

It seems that few writers are content to sit back and let the market tell its story. In today's competitive world, patience doesn't sell, and it's "be right," "be forceful", "be certain", but never be patient and never let the market spin out its story in its own good time.

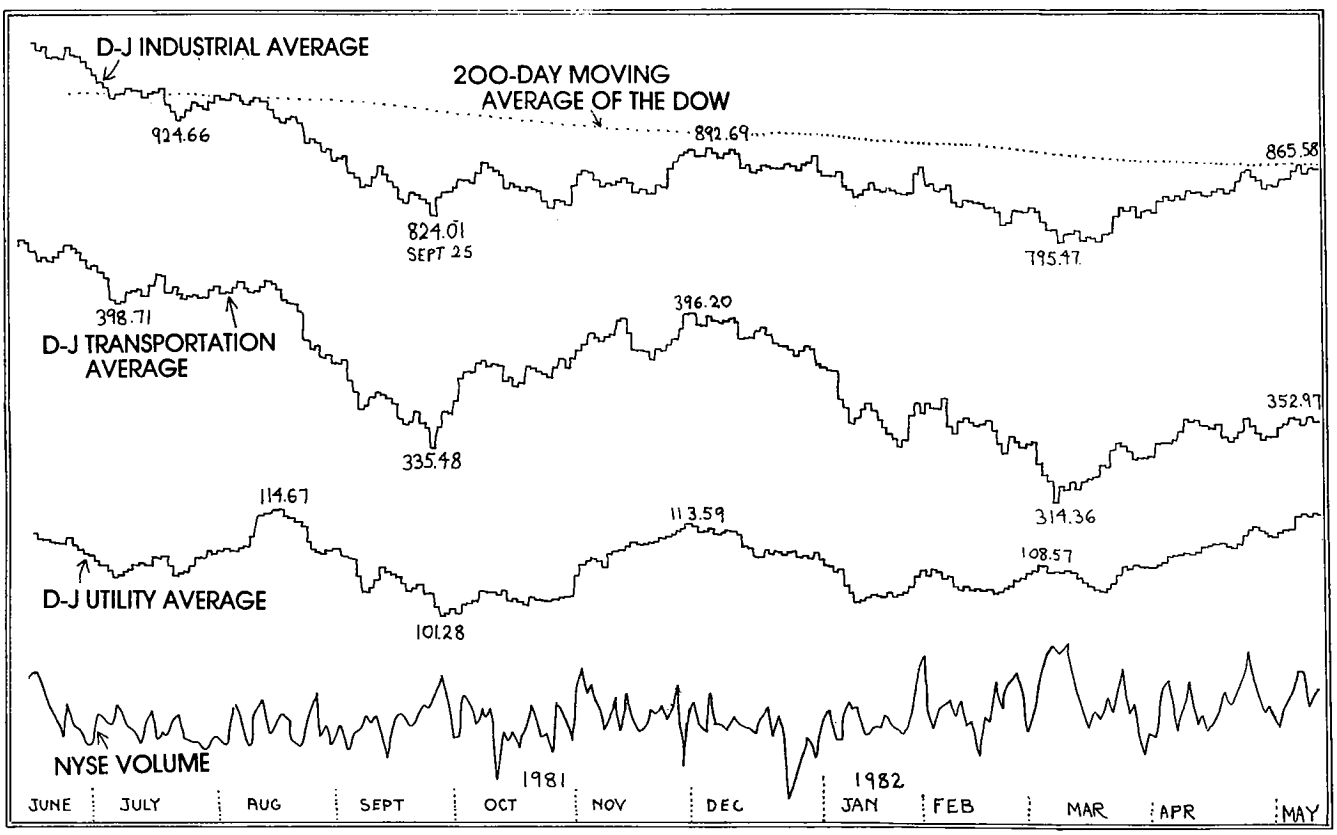
Two Letters ago I predicted that we were moving into a period of deceptiveness, uncertainty and confusion. Readers, we are there. And I would guess that this period is going to last into mid-summer or to around July. Then I expect the picture to become clearer. But there are just too many "geniuses" making too many widely-publicized forecasts today. By summer their voices should be stilled.

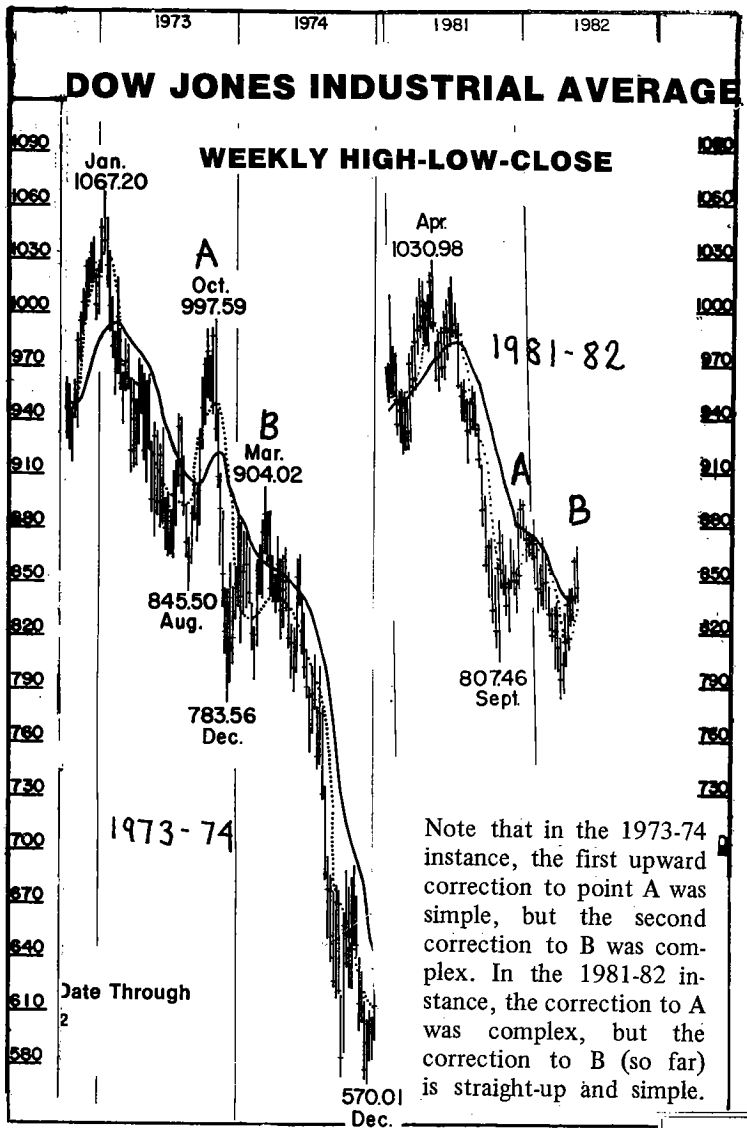
As for the D-J Averages, the Transports hit a closing high of 352.97 on May 6. A day later the Industrials recorded a closing high of 869.20. Significantly, the Industrials (see chart below) touched exactly on their 200-day moving average line. From a Dow Theory standpoint, nothing has been proved by the recovery rally. But the over-sold condition of the stock market (and almost every other market) has been worked off. The stock averages have advanced—so has gold, bonds, credit instruments of all types, oil, and a wide list of commodities (all except lumber, which has totally collapsed).

FRONT PAGE COMMENT: The jaws of the $5 billion debt-monster continue to squeeze the American economy. We're past the era of painless stand-offs, past the era of phoney "solutions." The T-bill rate holds stubbornly above 12%—despite almost daily predictions of a "steady decline in interest rates." As I see it, all the rates have to do is STAY where they are, and the situation will deteriorate. With a huge number of US businesses (and individuals) still positioned for continuing inflation, the current costs of carrying their debt and inventory is more than many can bear. Results: cut-backs, lay-offs, price breaks, bankruptcies.

The equasion has definitely switched against the debtor—and in favor of the saver. The rush now is to get out of inflation hedges and into a liquid condition. The name of the new game is—CASH.

Many observers are of the opinion that any rise in the markets is a harbinger of better things to come. "Inflation is coming back," they cry, "business is turning up. Inventories are declining, car sales are rising, retail sales are picking up, the recession is ending." Maybe so, but remember my warning: bear markets are tricky, and the bear is a deceptive animal. The bear loves to frustrate and torture the bulls, and his favorite device is the "let up." What is the let up? This is the temporary cessation of pain, brought on by periodic market rallies and minor upturns in various economic indicators. Many of the staunch bears have been "softened up"





Note that in the 1973-74 instance, the first upward correction to point A was simple, but the second correction to B was complex. In the 1981-82 instance, the correction to A was complex, but the correction to B (so far) is straight-up and simple.

by the March-May rally, and the latest consensus is, "Maybe one more decline, but the decline will halt at 820-830 or better, and it will be a major buy-spot." I hope this view is correct, and I hope it comes to pass. Meanwhile, I'm keeping an OPEN MIND on the whole picture. I operate on the principle that "It's hard to make money—and much, much harder to keep it."

COMPARISONS: I thought a comparison of the 1973-74 bear market with the current bear market would be well worth the effort. To this end, I have made a montage of the chart above from Mansfield (Journal Square, Jersey City, NJ 07306). On an intra-day basis, the initial plunge in the Dow in 1973 took that Average down a total of 222 points (1067 to 845). The initial plunge during 1981 took the Dow down a total of 223 points (1030 to 807).

Following the initial plunge in 1973, there were two violent upward corrections (in quick succession), the first to 997 (A on chart) in late-1973 and the second to 904 (B) in early 1974. Following the correction to point B, the Dow plunged 334 points to a final low in December, 1974.

Turning to the present, we note that following the initial plunge to 807 there have been two upward corrections, the first to point A and the second (still in progress) to point B.

What happens next? Will point B in the present instance be followed by a sickening plunge as per the 1974 instance? Obviously, no one knows. But my point in showing this chart is to demonstrate that the market today at point B looks very similar to the market in 1974 at point B. Whether, following this rally, the Dow will test the low, or whether it will break the low (as per 1974) and plunge to lower levels we cannot know or predict.

However, I do want to make a few observations about the action since the March, 1982 lows. (1) Usually in a strong rising market there are a series of at least three successive days in which there are 1000 or more advances. This has not occurred in 1982, and, in fact, there have been only six days (none in succession) in which advances were above 1000.

(2) The negative volume index hit a new bear market low on May 13. This is certainly atypical action, if this is to be an impressive rise. I cannot remember a major rise in which the negative volume index failed to move up to some extent (note: negative volume is based on the plurality of advances over declines on days when total NYSE volume is lower than volume on the preceding day).

(3) Daily new highs on this rise hit a peak of 97 on April 27. Since then the daily new high list has dropped dramatically. From this standpoint, the rally seems to be losing strength as the Dow pushes higher.

(4) The upward corrections during the 1973-74 bear market (see chart) were explosive, the first (ending in October, 1973) showed a new gain of 152 points, while the second (ending in March, 1974) produced a net gain of 121 points. During bear market rallies, upward corrections have a habit of looking mighty convincing (to the bulls) before they end.

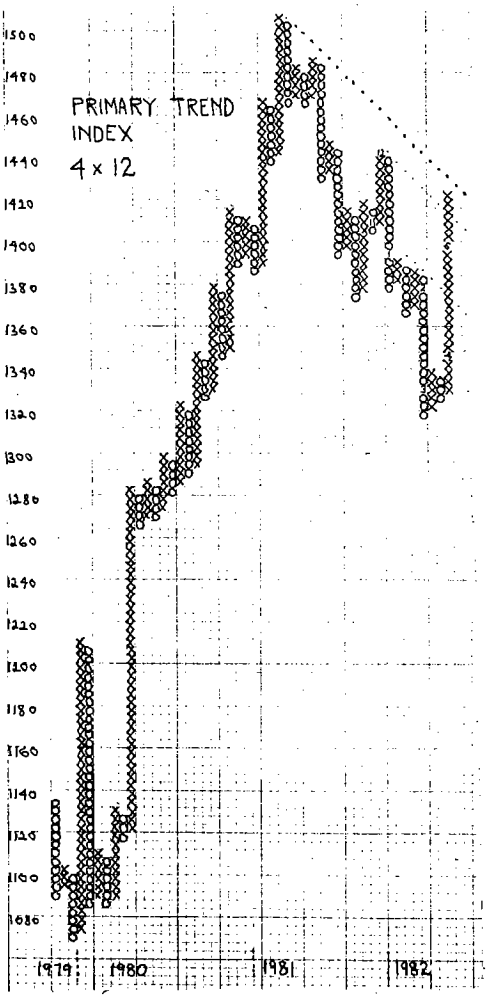
PTI, 1973: The Primary Trend Index (PTI), is my own proprietary index. It's an amalgam of eight averages and technical indices, each weighted to produce a single figure at the close of each day. I have run the PTI tabulations on a daily basis since 1981. Veteran subscribers know that the PTI is a market index that has proved its worth.

Here are a few rules I have formulated from my PTI studies:

(1) Never be positioned in the market against the PTI. It's optional whether you wish to be positioned with the PTI, but never go against it.

(2) A persistent trend in the PTI will ultimately take the market with it. The test of a PTI trend is based on trendlines and the ability of the PTI to better important preceding peaks (or to break below important preceding low points).

(3) If, during an extended period of time, the PTI fails to move the market or if an extended move in the market fails to move the PTI—watch out, the trend is about to reverse (often in a major way).



A question I receive constantly from newer readers is, "What did the PTI look like in 1973—at the top?" The lower page 2 chart should answer that question. On January 11, 1973 the Dow pushed to a record high (never since surpassed) of 1051.70. The PTI roared up to a value of 1096.

The Dow and the PTI turned down. By March the PTI had fallen to 952. The PTI then rallied. The Dow, completely ignoring the PTI, continued to fall. By May the PTI had climbed to a peak of 1075—21 points under its January high. The divergent action continued with the Dow falling to 851.90 in August.

Incredibly, the Dow started up again, and this time it was the PTI that ignored strength in the Dow. By late-October the Dow recorded a high of 987.06 (despite the fact that the PTI was heading stubbornly downward). But after the 987.06 high, the Dow tumbled, following the PTI to lower levels in a persistent and violent decline. In the smash that followed, the Dow dropped 410 points—to a final low of 577.60 recorded in December, 1974.

Conclusion: In retrospect we now know that the period of January to October, 1973, was one of massive distribution of stocks (even though the Dow in October, was only 64 points under its 1051.70 record high of January 11). The divergence, the refusal first of the Dow to follow the PTI and then of the PTI to follow the Dow were both signs of distribution.

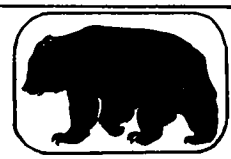
As has happened so many times prior to major stock market collapses, the indicators got "out of gear." The erratic action of the Dow and the PTI over a confusing 10 month period preceded the worst crash since the 1930's.

For this week's Letter, I am including a point & figure chart of the PTI. This is a 4 x 12 chart, meaning that every box represents 4 points on the PTI, but only rallies or declines of 12 points or more are depicted. The chart provides a concentrated picture of every 12 point or more move in the PTI since late 1979.

The chart shows a major top formation, a top which I have discussed many times in previous Letters. The top started forming in the 1380-1400 area during late-1980. The peak was recorded at 1508 in early-1981. From there, the PTI headed down. On March 17, 1982 the PTI recorded a low of 1320. Since then the PTI has been climbing steeply. On May 12 the PTI hit a high of 1424, a fat 104 points above its March 17 low. As you can see, this is the largest uncorrected rise in the PTI since the extraordinary 160 point rise of 1980.

When this rise in the PTI ends, we will have to judge subsequent action carefully. If the PTI forms a secondary top and breaks down, we will know that the bear market is resuming. If, however, we see the kind of action that occurred after the big rise of 1980, we will have to rethink our entire position. Remember, we think and theorize on the basis of market probabilities and past case history. But we OPERATE in the market on FACTS, and the action of the PTI is one of the premier facts that I present in these reports.

INVESTMENT POSITION: We're still sitting with our various money instruments, the bulk of them short-term (91-day T-bills). Frankly, the bond market looks somewhat toppy to me, and those of us who did buy bonds and notes have small profits. I stated 10% to 20% in bonds and the same percentages in 2-4 year notes, so there's no big risk in our position, regardless of what happens. But be careful, and at any sign of sliding bond prices, take your profits and—back 100% into T-bills.

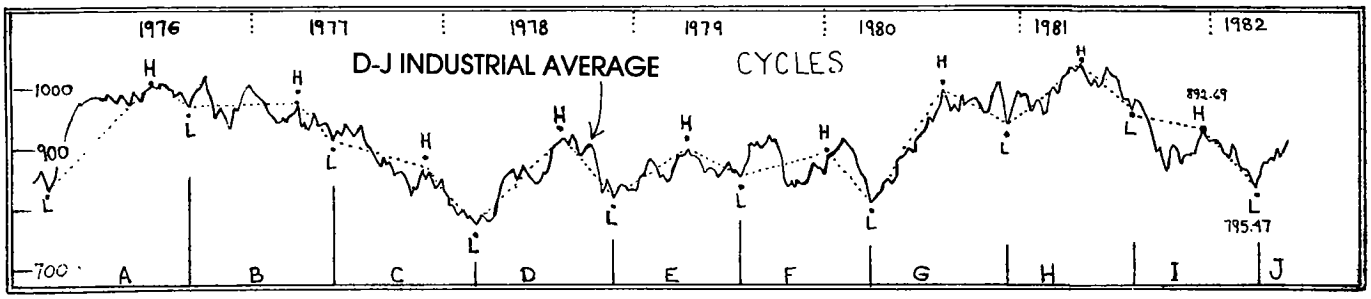


The stock market looks tired, but it could hang on until the bear segment of the 233-day cycle tops out in July. To my knowledge, no big killings have been made trading this latest rally. So sit tight, and play it conservative. It's going to be (in my opinion) one long, hot summer.

CYCLES: As older readers know, I follow a single cycle which I call the 233-day cycle. And I've frankly been surprised at how useful this study has been.

The 233-day cycle is made up of two segments, a 144-day bull segment and an 89-day bear segment. On the page 4 chart I have shown all the 233-day cycles going back to 1976 (ten cycles in all). I usually allow a few weeks one way or the other in identifying each top or bottom, but so far the cycles have "worked" remarkably well.

"But what happens," you ask, "when a cycle hits a low, as was the case during the beginning of the C cycle, and the market (instead of rallying with the bullish segment of the cycle), continues to go down?" And the answer is that when the market fails to respond to the cyclical influence, you know that other (stronger) counter-forces are in command. For instance, following the pathetic "bull segment" performance in the early part of cycle C, the market plunged during the subsequent bearish segment.



Perhaps significantly, there has never been a bearish segment of any cycle since 1976 that did not produce lower prices. Conversely, however, bullish segments during cycles B, C and I failed to produce higher prices.

The I cycle hit a low on March 17, 1982 with the Dow at 795.47. Subsequently, the bullish segment of the J cycle took over, and we are in the bull segment of the J cycle now. What I am watching is to see whether the bull segment of the current J cycle can take the Dow above the peak of the bull segment of the preceding I cycle (that high was the 892.69 peak of December, 1981). If the current bull segment cannot better the preceding bull segment peak, it will be a sign of weakness for the market.

The current bull segment of the J cycle is due to top out around mid-July (give or take a few weeks). After that the bearish segment will take over. This jibes with my thesis that an important "buy spot" for the market should appear sometime this fall.

IT'S HARD: Before I started in this business I made a long and detailed study of the writings of Robert Rhea. To my mind, Rhea was a genius. He wrote a report called "Dow Theory Comment," the first issue of which was published in November 1932. Rhea had successfully called the bottom of the great 1929-32 bear market–called it to the exact week (week of July 8, 1932). Rhea continued his market calls with fabulous success. He identified the bear market of 1937-38, and his subscribers were amazed at his accuracy and skill (and the profits which accrued thereby).

Then came trouble. During the 1938-39 period the market movements became very difficult, very puzzling. Rhea, like everyone else, was confused. Rhea died in late-1939, and I always suspected that the stock market had played a part in killing him. After his success during 1932-37, the frustrations of 1938-39 were enough to drive Rhea up the proverbial wall. At any rate, Rhea's death was a great tragedy. Rhea's writing during the 1932-37 period is, to my mind, the best to ever have come out of the stock market.

E. George Schaefer started his famous "Dow Theory Trader" report in 1948. Schaefer, a great Dow Theorist like Rhea, correctly called the bottom of the bear market in June, 1949. His reasoning in his June, 1949 letter was absolutely brilliant. Schaefer, in my opinion, was a stock market genius. All during the 1949 to 1966 period Schaefer stuck to his basic belief–that a great bull market was underway. Over and over again, as the bull market shook out the faint-hearted and the disbelievers, Schaefer insisted that the primary bull trend was intact. Again and again history proved Schaefer to be right. When the 1966 top appeared (amid great bullishness on the part of Wall Street) Schaefer announced to a disbelieving world that the great bull market was over. Schaefer assumed a strong bear position, held to that position–and advocated the purchase of gold shares.

During 1973-74 the gold situation became very tricky. Schaefer (for once) became confused. The gold shares collapsed during 1974 and Schaefer was in the position of not only advocating retention of gold shares, but of holding large amounts of the gold shares in his own account. I don't know exactly what transpired, but on September 19, 1974 Schaefer took his own life. I heard about it and was in a state of shock. A second genius (and friend) had fallen to Wall Street. I thought long and hard about the meaning of this tragedy.

What had I learned from all this? What was my conclusion? My conclusion was that no one, nobody, no human being can be right about the market all the time. You can have great streaks, you can have years of success on Wall Street, but you cannot (and I don't care if you are a flaming genius) win 'em all. The market is seldom easy, it is usually difficult, and at times it is impossible. If you cannot accept your own fallibility, if you cannot, at times, say "I don't know," then you are heading for trouble and very likely disaster.

The fact is that there are times when both the bulls and the bears can make a convincing case for their side. And there are times when no man knows exactly what is happening on Wall Street. At such times, wisdom dictates that you tread lightly, hold small positions in securities, and wait for the signals. I've learned that in my studies of Rhea and Schaefer, and I've learned that the hard way–through my own experience. I'm hoping that you, my readers, can learn that lesson through reading this piece rather than through personal losses and sleepless nights. If you can, then the price of your 1982 subscription might yet prove to have been a real bargain.

MONEY: This is how Salomon Brother's Henry Kaufman sees it (from his April 30 report):

"An extraordinarily large volume of Government securities will have to be issued along the entire maturity spectrum to finance a budget deficit of around $150 billion in the 12 months starting July 1. Who will buy all of these new obligations? The commercial banks, that frequently bought a large volume of Governments during business recessions and early recovery periods when loan demand was slack, are now large lenders to business. OPEC purchases of Governments are drying up. To be sure, someone will have to buy this large volume of new issues. In the current setting, however, this means that the lion's share of these new obligations will have to be acquired by individual investors. Consequently, private credit demands are likely to be squeezed out, further weakening the financial resources of the business sector and quickly strangling the next economic recovery."

For the rest of the year , figure it this way: the Treasury will have to borrow about $50 billion in the third quarter and an additional $40 billion in the fourth quarter. From all appearances, there will be a surge of red ink between now and the end

of the year due to Social Security increases, tax cuts and shortfalls from corporate and individual tax receipts.

Following their horrendous 1978-81 collapse the money markets have put on a good 9-month show, the rally having started from last year's September low. My feeling is that the "easy part" of the bond market recovery is now past. From here on, the money markets(which has now fully corrected the 1978-81 crash) are going to be looking at red ink out of Washington–ocean's of it.

Note, by the way, how the 91-day T-bills refuse to break below the 12% yield level. Technically, I regard 13% as the "trigger level" for T-bills. If the bill yields push above 13%, they should be off and running on the upside (such a move would constitute a major shock for the stock and money markets–see last Letter).

THE PICTURE: It was about 1978 that I started harping on the debt and the disastrous consequences of the debt and deficit production that the US was following. It was in the year 1980 that I stated that the US had passed the "point of no-return" in debt? This is the point at which continuing rising debt fails to produce inflation or any other "benefits," to the economy.

We've passed the point of no-return in debt, and it's the failure to understand this condition that is mystifying and confusing the so-called "experts" today. The biggest increase in the US budget this year will be interest rates or the cost of carrying the debt. The increase this year will be about 30%. This year the total Federal *interest costs* passed the $100 billion mark for the first time, probably rising to about $115 billion. That, in case you didn't realize it, comes out to $2.2 billion PER WEEK IN INTEREST COSTS.

"But Russell," you argue, "You still haven't explained why we have crossed the point of no-return!" And the answer is this: the US has been living over its head since World War 11. "Prosperity" has been built on an edifice of deficits and debt. That debt has been expanding and compounding for decades. And along with the towering rise in outstanding credit, came a rise in interest rates.

Around 1980 I felt that the debt structure began to take on a life of its own. Suddenly, the total debt of the nation ($5.8 trillion) became a burden that was so huge that it became the tail that wagged the dog (the dog being the economy). For example, the OMB estimate for total Federal and Federal related borrowing in 1982 is $206 billion. But national net savings this year is only $223 billion. Thus Federal borrowing will take up 92% of all savings. Next year the figure will rise to over 100%. And that is what is bringing on the crisis.

How do the politicians react to all this? They apologize for the current budget and promise to "do better"on future budgets. The latest is the Democrats' plan for $151 billion in new taxes and $426 billion in spending cuts over the next three years. New taxes on what? Spending cuts where?

Ah, the problem, you see, is that in an economy that has been living off debt and deficits, when you cut the spending you bring on even harder times, income to the government declines even further and the deficits ultimately get even bigger. And all the while, interest rates stay high (and as they do, they compound the existing debt).

So there is political poison in either raising taxes or cutting spending. Then how about simply opening the money gates and flooding the land with greenbacks (in the form of new loans and new handouts)? Here again we face severe problems. The money markets are now hanging on every move of the Fed. There are widely-quoted Wall Street analysts who make a living by analyzing every action of the Fed. If the Fed were to move towards its old policy of monetizing the debts (i.e., buying Treasury debt) the bond markets would smell inflation and protect themselves.

How does the bond market protect itself? In the only way any market protects itself–by declining. So a Fed policy of aggressive ease would send the money markets, (bonds, notes, mortgages, C/D's, etc.) reeling lower, and at the same time interest rates would go through the roof.

What's the alternative then? I see only three ultimate courses. (1) A mandatory balanced Federal budget. This would probably cause a depression, since at this stage of the game a balanced budget would entail a huge rise in taxes to meet spending, or it would entail a huge cut in spending to match the tax take. A balanced budget would probably send interest rates to the lower depths, but that would not have immediate bullish consequences, except for bonds (for instance, interest rates were very low all during the depression of the 1930's).

(2) Massive cuts in government spending could be an ultimate answer. But the pain connected with such cuts would prove to be a terrible political liability, and it is doubtful whether either party will purposely cut spending to any meaningful degree.

(3) The flat-rate income tax might be an answer to the deficit problem. Thus, a flat rate of 16% on ALL income (individual and business) would balance the 1983 budget. But a flat-rate tax would put the "income tax industry" out of work, and the political power of those who profit from the complex graduated income tax system is tremendous.

Will any of these contingencies occur? Not now they won't. But as the US economy stifles in its debts, as the cost of carrying the debt rises, as interest rates refuse to come down, new and original solutions will appear increasingly attractive. Ultimately, sanity will reign. And sanity, following 40 years of debts and inflation and boom must take the form of a number of years of debt-removal, deflation and depression. At any rate, for the long-term, that's the way I see it. And I handle my own investments with these thoughts in mind.

NOTES & QUOTES: The last couple of weeks were not vintage ones. Among the new items: Braniff International (airline) went under with debt near $1 billion. The state of Michigan saw its debt rating drop, and state income taxes were raised in Michigan. The value of US farmland dropped 1% during 1981, the first drop in 27 years. The stock of Datapoint hit a low of 12, down from a high of 50. The fund favorite has cost its holders a bundle. For instance, T. Rowe Price still owns 1.6 million shares while Citicorp owns 500,000 shares.

* *

Life may not be getting any easier in the US, but it is getting longer. In 1981 life expectancy, from birth, for the total US population rose to a record high of 74.1 years. According to Metropolitan Life, if you are a man of 25 you can expect to live 47.5 more years (women 54.4). If you are 45, expect to

live 29.3 more years (women 35.3 years). If you are 65, and a man, expect to live 14.4 more years (women 18.7).

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Land Ahoy: The Dept. of Argriculture reports that foreigners ownership of land jumped 63% (!) in 1981 over 1980. Foreigners now own 12.7 million acres of US land.

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Flash! The Arabs still have money. An official of Washington D.C.s summer youth program said, "I had to go to Saudi Arabia to get $50,000 for the summer youth program. The timely gift came from Shiek Muhammed S.A. Al Fassi."

At the same time, Page Avjet Corp. said it is building a gold-fitted 727 jet for another Arab sheik. As they say, "If you've got it, flaunt it."

ORLANDO, FLA. (UPI) – An oil-rich Saudi Arabian sheik has ordered a 727 jet turned into a gold-adorned flying palace that will make "Air Force One look like the bad side of the tracks."

The golden customizing touch will cost between $4 million and $6 million and is being handled by Page Avjet Corp. Company president Vincent Deluca says it is the most elaborate job the firm has undertaken in the 10 years it has been refurbishing planes for the rich.

Waterford crystal lamps, a 24-karat gold shower rod and three $25,000 microwave ovens are among the luxuries that decorate the jet.

The shiek's stateroom, office, lounge and kitchen are in the middle of the airliner, with living quarters for his staff in the rear and the American flight crew in the forward section. Each area has its own kitchen, bathroom and lounge so the crew and passengers won't disturb the sheik.

The master stateroom has two velvet-like couches facing each other across a gold-inlaid coffee table. At a touch of a button, the sheik can raise the table to dine or lower it into the floor to allow the couches to fold into a "prince-sized bed.

* *

Why, why did Argentina "capture" the Falklands and set off an international confrontation? Put it down to Russell's third rule: "Any government will do whatever it has to–to perpetuate itself."

The Falkland adventure was the Junta's way of taking the Argentine peoples' minds off the homefront disaster. The inflation rate in Argentina is 150%, joblessness in Argentina is above 13%, and the estimated first quarter drop in real GNP was 4%. Last year the Argentine GNP dropped 6%. To put it bluntly, the Argentine economy was (and is) in shambles.

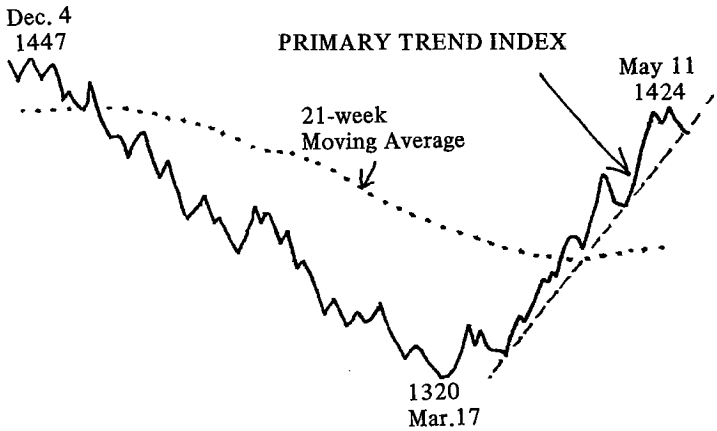
The war has already cost Britain $2 billion. Worse, the Argentine military capability was vastly underrated by Britain. Argentina has at least 170 long range bombers as well as the latest in sophisticated French and Israeli missiles. Britain has no large carriers, and is forced to use the short-range Harrier "jump-jets" (range from ship–50 miles one way). Without air superiority Britain will have its hands full. In fact, without control of the air it is highly doubtful whether any nation can win any war.

Argentine problem: the country owes $32 billion to international bankers, and that entails interest payments of $4 billion a year. Default, say some bankers, isn't impossible.

BOOKS: Did you ever day-dream about maybe committing a little fraud on your income tax? Did you ever worry that maybe your 18-year old is selling a little coke? Well, if you have, let me recommend the perfect antidote. It's a new book entitled, "Concrete Mama, Prison Profiles from Walla Walla." This shattering volume (many photos) will give you an intimate view of what prison life is like today (state penitentiary in Washington). Let me tell you, this book by 2 newspaper reporters is a revelation! Since over 329,000 Americans are now in prison, you might call the book an intimate visit to the convict community. Published hard-cover by Univ. of Missouri Press (about $25).

LATE NOTES: Last week's figure on the money supply (up $800 million) was no surprise, but the jump in business loans was–up a whopping $2.8 billion! Who's borrowing these huge sums with the nation in recession? The only answer I can come up with is, corporations who need the money to stay alive. There's no question about it, one of the major pressures on interest rates is the massive "survival borrowing" coming in as many corporations face the financial squeeze of their lives.

Meanwhile, here's an up-date on the daily PTI. Rallying from its March 17 low of 1320, the PTI recorded a peak on May 11



of 1424. A fairly steep but valid rising trendline can now be drawn, and the latest figures show the PTI breaking fractionally below that trendline. My interpretation is that the peak of strength for the market rally has probably passed. The question, from the PTI standpoint, however, is this–will the uptrend from the March 17 low be sustained, or is the PTI in the process of forming a top? We should know soon enough.

GOLD: Perhaps the most important facts about gold are these: the 50-week moving average (MA) for gold is 400 even. This is the MA which I call the primary trend line. This line is still declining. The 13-week or intermediate MA for gold is now 348, 52 points BELOW the 50-week MA. Finally, the 5-week MA for gold is 340, 8 points below the 13-week MA. Thus the three MA's are still in the bearish position.

The advantage of the moving average studies is that if you follow them and invest with them, you must (by definition) be on the right side of any major move. True, you might get whipsawed, you might get temporarily fooled, but if a big bull move is coming, the 5-week MA will climb above the 13-week MA (which constitutes an early buy signal) and next the 13-week MA will climb above the 50-week MA (which constitutes a major buy signal).

Well, the bull signals have not arrived yet. I continue to "believe" that the 312.50 low of 1982 was probably THE low for gold. But I don't want to recommend the yellow metal until we can identify a bull trend. I can't yet.

NEXT MAILING: June 3rd